STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 97-793

July 23, 1998

SEARSPORT WATER DISTRICT
Proposed Increase in Rates

FINAL ORDER (Part 2)

I. SUMMARY

In this Order we ratify the revenue requirement for the Searsport Water District (District) previously established in Docket No. 95-375, *Searsport Water District, Proposed Increase in Rates* and authorize rate changes to increase the District's revenue to that level. We do not approve the District's proposal to eliminate its declining block rate structure and adopt a 600 cubic feet per quarter minimum allowance. We direct the District to use the proceeds and interest income from the Stockton Springs fire protection buy-out in such a manner as to use all principal and income within 12 years as described in this Order. To recover any remaining revenue deficiency due to lost public fire protection revenues, we further direct the District to increase its rates proportionately for all customers, including the Town of Searsport's fire protection charges. Any further revenue deficiency due to decreased water consumption will be recovered through an across-the-board rate increase for all metered customers. We uphold the District's accounting treatment of its Contingency Fund and direct the District to aggressively reduce system water losses and to report on its progress to the Commission. Finally, in light of the actions taken in this Order, we decline to order the District to negotiate a special rate contract with its largest customer, General Alum & Chemical Corporation (General Alum).

II. PROCEDURAL HISTORY

On October 20, 1997, the District filed a proposed increase in rates pursuant to 35-A M.R.S.A. § 6104, to take effect January 1, 1998. The District held its required public hearing on November 18, 1997. Following the hearing, the Commission received a petition from more than 180 customers asking the Commission to suspend and investigate the rates. The Commission suspended the rates on December 18, 1997, for a period of nine months from October 20, 1997, to allow further time to investigate the increase.

At a subsequent prehearing conference, petitions to intervene were granted for the Town of Stockton Springs, the Town of Searsport, J.R. Mueller, the Office of the Public Advocate (OPA or Public Advocate) and General Alum. After additional prehearing conferences were held, the parties filed written comments in lieu of prefiled testimony and an evidentiary hearing was held on June 4, 1998. Two late-filed exhibits were received and are hereby admitted without objection: (1) General Alum #15; and (2) Mueller #2. The parties filed briefs and reply briefs and an Examiner's report was issued on July 9, 1998. Parties filed exceptions on July 14, 1998. The Commission deliberated this matter on July 17, 1998, and issued a short order under Section 1003 of our Rules of Practice and Procedure on July 20, 1998. In compliance with Section 1003, this full Order follows.

III. ANALYSIS

A. Accounting For and Use of the $345,000 Stockton Springs Buy-Out

1. Positions of the Parties

On December 2, 1996, the residents of the Town of Stockton Springs voted at a special town meeting to authorize a one-time payment of $385,020 to the Searsport Water District to discontinue public fire protection service from the District. Of this amount, $39,500 was intended to cover the cost of removing the hydrants from Stockton Springs. The District treated the balance ($345,520) as a Contribution in Aid of Construction and invested it in a secured bank certificate, at 6% interest, maturing May 3, 1999. In its brief, the District stated that it intends to continue to invest those funds until it is able to use them to redeem a bond that is equal to the principal amount of the investment or it may use the funds for a future capital improvement project.

The OPA has taken issue with the District's proposed use(s) of the buy-out proceeds and urges the Commission to use the $345,520 buy-out proceeds and interest income to reduce the District's rates in the short term (*i.e.* over the next 4 to 8 years). Mr. Randy M. Allen, the OPA's Consultant, testified that "[i]f you maintained that plant asset on your books then the other alternative would be to take those monies and add them to your accumulated depreciation reserve which would reduce rate base and reduce revenue requirement." General Alum urges the Commission to use the funds to offset fully the loss of fire protection revenue from the Town of Stockton Springs. General Alum further states that the "District's proposed use of the proceeds violates common sense, accounting rules, and good public policy,"[1] and that "only a strained interpretation of the applicable accounting rules could support such a treatment."[2]

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[1]Brief of General Alum at 3.

[2]Brief of General Alum at 5.

Messrs. Armstrong and Mueller urge the use of the buy-out proceeds to offset the lost fire protection revenues over an 8-year period.

2. <u>Accounting Issues</u>

We address first the accounting issues associated with the buy-out proceeds. The uniform system of accounts provides guidance and instructions for most accounting entries utilities make. It does not, however, provide specific guidance for all possible transactions. The Stockton Springs buy-out is an example of a transaction requiring a careful review of the basis for and the objective of the transaction in order to determine its proper accounting treatment.

Therefore, we must examine the intent of the parties to the buy-out stipulation. Mr. Hodsdon testified on behalf of the District that the buy-out proceeds were intended to compensate the District for the costs of the facilities maintained to provide public fire protection to the Town of Stockton Springs. (Tr. C-3, 4) After review of the Stipulation in Docket No. 94-384, *Searsport Water District, Town of Stockton Springs Fire Protection Buy-Out*, we agree with Mr. Hodsdon that the $345,520 buy-out was intended to compensate the District for facilities already installed and operated to provide public fire protection service to the Town of Stockton Springs.[3] The District had invested substantial amounts to construct facilities necessary to provide public fire protection service to Stockton Springs. In all, the facilities were constructed in various years and most of those facilities were financed by the District's outstanding bonds, which mature in 2018, 2031, and 2036. Although the buy-out proceeds were certainly intended generally to limit the rate impact of Stockton Springs' decision to cease fire public protection, this continued rate impact is due more to the bonded indebtedness related to the construction of those facilities than to the revenue lost from the Town of Stockton Springs. We find that the purpose of the parties to the buy-out stipulation was to compensate the District for the facilities "stranded" as a result of the Town's decision to cease public fire protection.

Contrary to General Alum's argument (Brief of General Alum at 6), the basis for the buy-out was the cost of the facilities constructed to provide public fire protection service in the Town of Stockton Springs and the objective was to compensate the District for the cost of those facilities. There is no evidence in the record for Docket No. 94-384 (of which we

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[3] We are here not concerned with the treatment of the $39,500 portion of the buy-out that was specified to cover the cost of removing the hydrants from Stockton Springs.

take administrative notice) or this proceeding that will support any other conclusion.

It is our opinion that the instruction in the Uniform System of Accounts for Water Utilities for Account 271 Contribution in Aid of Construction (A)(1), applies to the buy-out transaction. The buy-out money was received by a utility, from a governmental agency, at no cost; it represents an addition to the capital of the utility, and is utilized to offset the construction costs of the utility's facilities used to provide utility services to the public. We do not believe that the fact that the Contribution in Aid of Construction occurred *after* construction and long-term financing of the specific projects had been completed should alter the accounting for this transaction. We would require the same treatment for an after construction/financing grant from the Rural Development Administration or the Drinking Water State Revolving Loan Fund. The primary factor is that the funds have been received to offset the cost of constructing facilities necessary for the District to provide service. Even though the District no longer provides the service associated with the facilities in question, the District's ratepayers are assuredly still paying for the construction of those facilities and are obligated to continue doing so for the terms of the related bonds.

In addition, the District's accounting treatment has the benefit of removing the "buy-out plant" from the depreciation base. This would not be accomplished by the accounting treatment (add the "buy-out amount" to Accumulated Depreciation) suggested by Mr. Allen (Tr. C-129). For the reasons set out above, we approve the District's treatment of the $345,520 as a Contribution in Aid of Construction.

3. Use of Buy-Out Proceeds

The second issue related to the buy-out is the District's application of the buy-out funds. With regard to this issue, it has been and continues to be this Commission's policy to match revenues and expenses. As discussed above, the buy-out funds were based upon the cost of plant that was financed with bonds that will be maturing over the next 30 or more years. The debt service on those bonds will be a part of the District's revenue requirement during that time period.

We reject the arguments that the $345,520 should be returned to the ratepayers by using it to offset completely the $52,000 of annual lost revenues until it is expended. The lack of a calculation of lost revenues or a discussion of any revenue deficiency in the buy-out stipulation indicates that the amount of lost revenues was not a basis for the settlement.

Furthermore, the immediate use of the buy-out proceeds to reduce rates over the next 4-8 years could reward the wrong customers. The Intervenors argue that the funds should be used to benefit current customers. That argument neglects the interests of those customers who will be paying the debt service on the outstanding bonds for the next 30 or more years; these customers will also be paying for the facilities associated with the buy-out stipulation. We must balance the interests of current customers with those of future customers, whose rates will include at least a portion of expenses associated with the stranded facilities.

On this issue, we agree with the position advanced by General Alum in its Exceptions to the Examiner's Report. General Alum points out that uncertainties regarding future expenses and customer base make it impossible to "match" with certainty any group of customers with the expenses associated with the stranded plant. For that reason, General Alum suggests that the Commission take a middle path and extend the use of the buy-out proceeds over a longer period than 4-8 years but less than the entire life of the outstanding bonds. We are of the opinion that the $345,520 should be managed in a manner that will maximize interest income on the principal while reducing the principal balance to zero over a 12-year period beginning with the year 1997. The District shall file a plan, similar to that proposed by General Alum in its Exceptions to the Examiner's report, that will reduce the principal balance to zero by year end 2009. The plan must address the need for future rate increases necessary to offset the reduced principal withdrawals and minimize the number of rate increase filings.

B. <u>Revenue Requirement</u>

The revenue requirement the District has requested in this proceeding is $536,962.00; this is the same revenue requirement stipulated by the parties in the District's 1995 Rate Case (Docket No. 95-375). (Tr. C-80.) Although the District identified other allowable expenses and/or income deductions (Tr. C-81, 116), it chose to continue to use the previously approved revenue requirement and revise its rates to regain revenue lost when the Town of Stockton Springs discontinued public fire protection service and General Alum substantially reduced its consumption.

The Public Advocate, in his brief (OPA Brief at 3 & 4), has proposed adjustments totaling $1,751 to the District's operating expenses (Chemicals -- $754 and Workers' Compensation Insurance -- $997).

While the public advocate has identified some relatively minor, but legitimate adjustments, it would be unreasonable to single out a few accounts for adjustments without reviewing all accounts for possible offsetting increases as noted by the District. Therefore, we make no adjustment to the District's revenue requirement but approve the continued use of the revenue requirement established in Docket No. 95-375.

C. <u>Public Fire Protection Charge to the Town of Searsport</u>

The District's filing proposes to hold the rate for public fire protection service to the Town of Searsport at the level established in Docket No. 95-375. This proposal is supported by the District's Cost of Service Study which has been updated to reflect the loss of the Town of Stockton Springs as a public fire protection customer and a reduction in metered sales to General Alum.

The Town of Searsport, in its brief, supported the District's proposed rate and indicated that the Town would be unfairly burdened if it were to experience a significant increase in its public fire protection rates. General Alum argues that the rate increase should be implemented on an across-the-board basis (Brief of General Alum, footnote 3 at 7) to all customers. The Public Advocate, through witness Randy M. Allen (OPA #5), proposed an adjustment to the District's Updated Cost of Service Study that would increase charges to the Town of Searsport.

We have reviewed the District's Updated Cost of Service Study along with the 1995 study upon which it is based. We find that Mr. Hodsdon attempted to update the 1995 study to reflect the impact of the loss of Stockton Springs as a public fire protection customer. He adjusted all allocation factors and tables in a manner consistent with the 1995 study. We also compared Mr. Hodsdon's public fire protection allocation with the result obtained by applying the updated revenue, expenses, debt service, depreciation, etc., to the 1995 allocation factors making no adjustments for the loss of Stockton Springs as a customer. From the resulting public fire protection allocation we subtracted the debt service and depreciation related to the $345,520 buy-out; 32.32% of the operation and maintenance expense, hydrant and water costs allocated to fire protection; 20% of the demand allocated to the fire protection; and a customer charge. The result of this limited analysis is very close to that produced by Mr. Hodsdon's updated study. While we may not agree with all of Mr. Hodsdon's allocation factors, Mr. Hodsdon uses an accepted methodology and the results of the cost of service study appear to be within the accepted range of reasonableness.

We reject Mr. Allen's proposed adjustment to public fire protection demand and the corresponding adjustment to the public fire protection charge to the Town of Searsport. Mr. Allen proposed to adjust the demand allocated to public fire protection based upon the number of hydrants to be removed from Stockton Springs. Mr. Allen is basing his adjustments on demand units which are numbers Mr. Hodsdon calculated based upon the percent of demand costs he assigned to public fire protection. Mr. Hodsdon did not use the demand units for allocation to public fire protection; it is merely a number calculated to fill a blank space.

The Town of Searsport argued that it is unreasonable for its public fire protection charge to increase simply because the Town of Stockton Springs chose to stop taking service; the demands of the Town of Searsport's fire protection service have not changed so neither should its charges. However, any other customer of the District can make that same argument. The simple fact remains that the Town of Stockton Springs is no longer a customer and the District must recover the lost revenue if it is to meet its financial and service obligations. Complicating this problem is the fact that the facilities constructed to enable public fire protection service to be provided to Stockton Springs do not disproportionately benefit any identifiable group of remaining customers; there is no single group that might logically be assigned the costs of the stranded facilities.

In these circumstances, notwithstanding the cost of service study evidence in this record, it is not unreasonable to expect *all* remaining customers to bear their proportionate share of the District's present revenue deficiency. At least in the near term, there is no compelling reason to place a disproportionate share of the revenue deficiency upon any customer class. We find that the remaining customers should make up any revenue deficiency in the same proportions by which they contributed to the District's overall revenue requirement before Stockton Springs discontinued public fire protection service.[4]

To that end, we require that the District establish a public fire protection charge to the Town of Searsport equal to $109,020 plus 22.64% of any revenue deficiency remaining after application of any buy-out proceeds and interest income in compliance with Section III(A) above. The balance of the revenue deficiency (77.36%) shall be recovered from the other remaining customers.

D. Metered Rate Design

[4]In order to account for 100% of the District's revenue requirement, Stockton Springs' former share of revenue must also be divided proportionately between the Town of Searsport and the metered customers.

The District's filing proposed two significant changes to its rate design. First, the District reduced the minimum allowance from 1200 cubic feet to 600 cubic feet per quarter. Second, the District changed from declining block rates for metered consumption to a flat unit rate. The District argues at page 3 of its Brief that "[t]he fairness is obvious in that customers only pay for the water they use. By reducing the minimum allowance, more than 35% of the customers will benefit from not paying for water they do not use. Also, customers all pay the same price for the water they use. No class or size of customer pays more per 100 cubic feet of water."

Messrs. Mueller and Armstrong oppose the proposed rate design as unfair and prejudiced towards a set of users. They state in their brief (Brief of Mueller & Armstrong at § II(A)(3)) that the decrease in the minimum allowance makes 170 "formerly minimum" customers subject to a larger percentage increase than most other customers. They also argue that the change to a flat metered rate skews the percentage increase at the various consumption levels. They believe that the District should retain the 1200 cubic feet per quarter minimum allowance and the declining block rates by applying an across-the-board percentage increase.

The Public Advocate proposes an adjustment to industrial demand based upon revenue lost as a result of a leak repair by General Alum. General Alum argues that the adjustment proposed by the Public Advocate is wrong because the rate design should be based upon General Alum's actual consumption. General Alum advocates that a rate increase approved in this case should be implemented on an across-the-board basis to all customers. This reflects General Alum's opinion that the District used a shortcut as a substitute for a careful rate design analysis to determine the public fire protection allocation.

The primary purpose of this rate proceeding is to adjust rates so that they will produce the level of revenue agreed upon in the Stipulation in Docket 95-375. The current rate structure resulted from that same Stipulation and, for that reason, we are reluctant to change from that rate design especially where the District's proposed consumption rate would greatly exceed the District's variable cost agreed upon in the Stipulation. We have not been presented with evidence demonstrating that there is a need for a change in the rate design at this time. We will require the District to retain the prior rate design by applying the increase required from metered customers to the existing block rates on an across-the-board basis. The Public Fire Protection charge to the Town of Searsport shall be determined as discussed above.

E. Contingency Fund Accounting and Unaccounted-For Water

General Alum raised two additional issues. First, General Alum challenges the negative balance of the District's Contingency Reserve Fund in light of the 1992 amendments to Chapter 670 and the prohibition against retroactive rate making. Second, General Alum pointed out that the level of unaccounted-for-water appears to have risen significantly in recent years.

1. Contingency Fund Accounting/Retroactive Rate Making

First, General Alum questions why the District should be permitted to carry a negative balance in its Contingency Fund when Chapter 670 of our Rules required that balances be reduced to zero as of January 1, 1991. The 1992 changes to Chapter 670, however, only required that "**positive**" (emphasis in original) balances in a utility's Contingency Fund be adjusted in a manner that resulted in a zero balance in the Fund on January 1, 1991. No adjustment is required for accounts having a zero or negative balance on that date. It appears, after review, that the district has accounted for the Contingency Fund in a manner consistent with Chapter 670.

Second, General Alum's retroactive rate making argument is also misdirected in this instance; the Contingency Fund Allowance simply does not result in rates being calculated retroactively. As required by 35-A M.R.S.A. § 6112, the allowance is calculated based upon the pro forma costs of operating the water utility. Any net income (loss) at the end of the year (within the limits established by Chapter 670) is merely added to the fund. In essence, the fund merely nets out (within statutorily prescribed limits) the District's annual operating deviations from its authorized revenue requirement. Rates are never set to retroactively recover any "lost revenue" represented by a negative fund balance any more than a rate reduction would retroactively refund any "surplus" represented by a positive contingency fund balance.[5] The Legislature has determined that a certain amount of contingency flexibility is desirable for water utilities and has specifically authorized and prescribed the use of contingency funds in Section 6112. Thus, the prospective nature of the contingency allowance in the rate making process refutes the Company's argument that a negative balance in the Contingency Fund results in retroactive rate making.

[5]We note that the Legislature has explicitly provided for *prospective* rate reductions to be made if a water utility's revenues result in excessive accumulations in its unappropriated retained earnings account, 35-A M.R.S.A. § 6112(5).

2. Unaccounted-for Water

General Alum noted that the unaccounted-for water in the District's system has doubled in recent years. The cause of this increase is not clear from the record. The District indicated in its Reply Brief (page 9) that it works very hard to locate and repair leaks, but with an old system, it is very difficult to find all the leaks. The District reports that it is planning improvements to those parts of the water system in need of replacement.

It is our opinion that the District should have an aggressive leak detection program to complement and provide data for its planning effort. Therefore, the District shall file with the Commission quarterly leak detection reports until its unaccounted-for-water is reduced to 15% or less. Those reports must include the dates each leak is detected and repaired, the street address of the leak, the size of the water main or service, the type of pipe and the year installed, and an estimate of the leak flow rate.

F. The Proposed Rate Increase Will Force General Alum to Explore Drilling Private Wells

Michael Harmon, General Manager of General Alum, testified (Tr. C-148) that the Company has had an analysis performed that indicates the payback for drilling private wells to supply its process and production water needs would probably be 27 months. The Company notes that, if approved, the proposed rate increase will force it to investigate further the feasibility of supplying its own water. General Alum believes that the optimal solution is for the utility and the industrial customer to negotiate a rate somewhere between the utility's marginal cost and average cost, thereby maximizing the industrial customer's contribution to the utility's fixed costs. General Alum suggests (Brief of General Alum at 15-16) that the Commission order the District to engage in good faith negotiations with General Alum and, if the negotiations are successful and the results acceptable to the Commission, increase the rates to the other customers by supplemental order.

General Alum is properly concerned about the rates it will be charged for its water purchases. This is also true of the other customers on the system, many of whom may have alternatives for water supply. The District must assume that any customer might leave the system if the rates exceed the cost of the customer's alternative supplies or make it impossible for them to compete. The District may wish to consider a contract rate for certain customers but should do so only after considering the customer's justification for special treatment along with the potential impact on other customers.

We note that although Mr. Harmon asserts (Tr. C-144) that General Alum is sensitive to its costs, he provides no evidence that the cost of the water purchased from the District is a significant factor in the Company's operating costs. The Company would also have to provide more substantial evidence than a proposal to evaluate a potential groundwater supply (G.A. Exh. 15) to demonstrate that it has a viable alternative sufficient to make a contract rate in the best interest of the other ratepayers.

Should the District consider a contract rate with General Alum, it must carefully evaluate its variable cost and its marginal cost. The marginal cost may be equal to the variable cost or it might be higher than the average cost. For example, before General Alum eliminated its leak, the District was operating very close to its maximum capacity. The marginal cost at that time probably would have included costs associated with developing another source of supply and connecting it to the distribution system.

On this record, we will not order the District to enter into negotiations with General Alum because we do not believe it to be in the best interest of the District's customers at this time based upon the rate changes approved in this Order. In evaluating the need to enter into a special rate contract with General Alum (or any other customer) in the future, the District should independently evaluate the economic and technical feasibility of any alternative water supply and, given the totality of circumstances, the likelihood of General Alum pursuing such a course. If a technically feasible alternative supply would cost less than continuing service from the District, and it appears likely that the customer will pursue the alternative, the District should consider negotiating a special rate contract. In negotiating a special rate, however, the District must ensure that the rate exceeds its marginal costs.

IV. CONCLUSION

Accordingly, we

O R D E R

1. That the Searsport Water District's annual revenue requirement is $536,962.00;

2. That the Searsport Water District shall develop a plan to use the proceeds and interest income from the Stockton Springs fire protection buy-out in gradually reduced amounts over a 12-year period;

3. That the Searsport Water District shall increase rates to all its customers to recover any revenue deficiency due to the buy-out (remaining after application of the buy-out proceeds and interest income) in the same proportions as those customers contributed to the District's revenues before the buy-out occurred. Accordingly, the Town of Searsport's public fire protection charge shall be $109,020 plus 22.64% of any revenue deficiency due to the buy-out remaining after application of buy-out proceeds and interest income;

4. That the Searsport Water District's proposals to adopt a 600 cubic foot minimum allowance and eliminate its declining block rate structure are not approved. Any revenue deficiency from metered customers due to both the buy-out and reduced consumption (remaining after application of the buy-out proceeds and interest income) shall be recovered through an across-the-board rate increase to those customers;

5. That the Searsport Water District shall implement an aggressive leak detection program and file reports on that program with the Commission until the unaccounted-for water rate is reduced to below 15%; and

6. That the Searsport Water District shall file amended rates in compliance with this Order.

Dated at Augusta, Maine this 23rd day of July, 1998.

BY ORDER OF THE COMMISSION

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Dennis L. Keschl
Administrative Director

Commissioners Voting For: Welch
Nugent

EXHIBIT A

$ 534,614	Pro Forma Revenue
- 1,000	Income from Merchandising & jobbing
533,614	Revenue from Rates Plus Revenue from buy-out
- 52,000	Lost Revenues from buy-out
481,614	Revenue from all Remaining Rate payers
-109,020	Revenue from Searsport Public Fire Protection
$ 372,594	Revenue from Non-public Fire Protection Customers

$\frac{109,020}{481,614}$ x 52,000 - 23,000 = $6,565 Audit from Searsport

$\frac{372,594}{481,614}$ x 29,000 = 22,435 Additional from Other Non-public Fire Protection Customers

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. <u>Reconsideration</u> of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.

2. <u>Appeal of a final decision</u> of the Commission may be taken to the Law Court by filing, within 30 days of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320 (1)-(4) and the Maine Rules of Civil Procedure, Rule 73 et seq.

3. <u>Additional court review</u> of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320 (5).

<u>Note:</u> The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.